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C O N F I D E N T I A L SECTION 01 OF 03 ABUJA 001009

SENSITIVE
SIPDIS

STATE PASS USAID FOR NFREEMAN, GBERTOLIN
STATE PASS USTR FOR LISER, AGAMA
STATE PASS OPIC FOR ZHAN, MSTUCKART, JEDWARDS
STATE PASS TDA FOR PMARIN, DSHUSTER
STATE PASS EXIM FOR JRICHTER
FOR GABORONE PASS PDROUIN
FOR BAGHDAD PASS DMCCULLOUGH
COMMERCE FOR KBURRESS AND DHARRIS
TREASURY FOR DPETERS AND AIERONIMO

E.O. 12958: DECL: 06/08/2024
TAGS: EFIN EINV ETRD ECON PGOV NI
SUBJECT: NEW CENTRAL BANK GOVERNOR WILL FACE CHALLENGES

Refs: A. ABUJA 921, B. ABUJA 938, C. LAGOS 186

ABUJA 00001009 001.2 OF 003

Classified by Ambassador Robin R. Sanders, for reasons 1.4 b and d.

¶1. (C) Summary: As presaged in ref A, President Yar'Adua nominated Sanusi Lamido Sanusi to head the Central Bank of Nigeria (CBN). Sanusi has been confirmed by the Senate and has taken charge at the Central Bank. Sanusi has a reputation for risk assessment and supervision, and his talents will be taxed in his new responsibility. Recent steps under Governor Charles Soludo buoyed Nigeria's flagging banking sector, but most industry insiders say the country's lender of last resort has insufficient will to address underlying problems. There are indications it may also lack necessary financial muscle to avert a crisis should even a small bank begin to fail. Measures introduced by the CBN since early 2009 have infused liquidity in the sector, and also provided better oversight and surveillance to detect signs of trouble. Nonetheless, there is universal consensus that the true health of the commercial banks is unknown, and several analysts and bank officials caution that the CBN has insufficient institutional and financial capacity to intervene decisively to avert a bank crisis. Most important will be whether Sanusi is able to stand up to efforts to undermine stronger supervision, and how much fallout there is at the CBN and in the banking sector from former Governor Soludo's reported massive payouts to power brokers in order to keep his job. End Summary.

New CBN Governor Takes Charge

¶2. (SBU) As presaged ref A, President Yar'Adua chose First Bank Managing Director Sanusi Lamido Sanusi to head the CBN. The Senate confirmed Sanusi on June 3 and he has taken charge. In his confirmation hearing, Sanusi promised closer scrutiny of Nigeria's commercial banks. He also stated that he planned a new Code of Conduct for all regulators, promised transparent rules, and opposed redenomination of the naira. He noted the importance of supporting the expansion of electric power supply and improving other infrastructure. He vowed support for the local currency and expressed concern that interest rates and the rate of inflation were

too high. Though the CBN had important achievements under Sanusi's predecessor, Charles Soludo, most of those were in the first half of Soludo's term (ref B), and the new Governor has inherited weighty challenges.

¶3. (C) On the political atmospherics surrounding Sanusi's appointment, during the Ambassador's June 2 visit to Lagos to meet with a number of banking, business, and political leaders there was a fair amount of disquiet in the South about Sanusi's appointment. The concern was not about his credentials as the CBN head, but rather the fact that there was no one from the South that was represented in President Yar'Adua's official (Cabinet) or unofficial circle on financial or monetary policy. With the appointment of the very conservative Sanusi, this was the last "nail in the coffin" for some who fear that the South will be further excluded from having a voice in macro economic decisions of the nation, particularly given that Yar'Adua's Chief Economic Advisor Yakubu is from Katsina, and new Finance Minister Muhtar is from Kano (also Sanusi's home state). Of equal concern for the southern-dominated banking community is that this all comes at a time when the global financial crisis is hitting some Nigerian banks hard (we understand that 3-4 may have major capitalization and liquidity challenges) on top of dwindling reserves (estimated by some interlocutors at about USD 40 billion rather than the published USD 45 billion, a drop of about 20 percent from the end of 2008), and even more sharply diminishing excess crude account funds (reportedly around USD 8 billion rather than the published USD 15 billion, down from a recent USD 17-18 billion) as the GON continues to dip into the latter to meet budget shortfalls and pay states their share of oil revenues.

¶4. (C) Meanwhile, the Mission should have adequate access to Sanusi as he is a close contact of the Ambassador, less arrogant than his predecessor, and although he has conservative political views, by all other accounts is a pragmatic economist. As noted ref A, he was the

only Northerner that was a Group Managing Director of any Nigerian commercial bank prior to his appointment as CBN Governor.

What's Ahead for Sanusi

¶5. (SBU) For the new CBN Governor there are a number of challenges ahead that he will have to address. Of note, they range from instituting a common-year accounting system for the banks, increasing oversight of the sector, and the prevalence of margin lending. Sanusi will not only need to grapple with all of these issues but also have to determine just how healthy or unhealthy Nigeria's banking sector is. The CBN has said the sector's exposure to margin loans is now 784 billion Naira (USD 5.3 billion), down from a peak of 1 trillion Naira (USD 6.8 billion), respectively. Most private sector contacts, however, doubt these figures. Lagos Business School professor and member of the President's Economic Management Team Doyin Salami on May 5 told Lagos EconOff he continued to have doubts about the banking sector and the extent of its losses, and suggested that several banks had attempted to hide losses in various subsidiaries. Afrinvest's Chioke noted the proliferation of short-term funding instruments designed to finance equity trading, other than traditional margin loans, accounted for as much as 20 percent of assets in some banks. Chioke noted that such vehicles were largely unregulated and falsely perceived to be safe. Access Bank's Chief Compliance Officer Pattison Boleigha added that the evaporation of confidence in margin lending was one of the triggers of the collapse of the Nigerian stock market beginning in March 2008. Indicating the possible size of these risks, private research company Renaissance Capital recently estimated that nonperforming loans would double in eight of the 11 banks it monitors.

Limited Arsenal To Avert Crisis

¶6. (SBU) Although none of our contacts are forecasting the imminent collapse of a bank, several financial watchers warn that the CBN almost certainly lacks the institutional and financial muscle to address a crisis should one occur. We will have to see if Sanusi can turn this around. According to Boleigha and Teriba, the tremendous

growth of the financial sector in recent years had outpaced the CBN's regulatory capacity. Talented central bank staffers were quickly poached by top banks and the drive for profits superseded internal controls and proper risk management. In addition there were also reports that the CBN under Soludo was complicit with some banks in attempts to mask balance sheet shortcomings. Financial experts have called for the CBN to be stripped of its bank regulatory function, suggesting that role go to an independent agency akin to the British Financial Services Authority, leaving the CBN with the sole role of conducting monetary policy.

¶7. (SBU) Of particular concern to some of our contacts is the CBN's limited financial resources available to prop up a failing bank should a run begin. One bank insider said the CBN has already disbursed the equivalent of USD 2 billion to FCMB, Finbank, and Access Bank via the expanded discount window (ref C) and speculated that the government's issuance of the 200 billion Naira (USD 1.4 billion) agricultural bond was an attempt to bail out UBA and First Bank, which have received 75 billion Naira (USD 510 million) and 25 billion Naira (USD 170 million), respectively. Boleigha meanwhile agreed that the CBN's capacity to raise local funds was limited by recently imposed interest rate caps, persistent inflation, and the government's large fiscal deficit.

¶8. (SBU) There are others who are arguing that the CBN would have sufficient recourses to handle a banking crisis, provided the stock market rebounds. Teriba noted that falling interest rates on Nigerian government securities would eventually lead investors to return to equity markets that would become more attractive as interest rates fall. (Note: The future course of interest rates, the key to this rosy scenario, is very much in doubt especially as the government will almost certainly have to increase borrowing to finance a budget deficit that the IMF expects to equal 8.5 percent of

GDP this year. End Note). We understand that the CBN has 4.5 trillion Naira (USD 30 billion) in government deposits that it could lend to troubled banks, but at the same time the impact of such a move is potentially inflationary.

¶9. (C) Comment: The vulnerability of Nigeria's banks to toxic equity-backed assets is unclear and even the most informed contacts we talk to will likely not be able to provide much of an early warning should a bank run begin. What is clear, however, is that the tremendous growth in bank assets over the last several years was in part a mirage generated by easy credit, loose accounting standards, and possible outright collusion among banks to manipulate the equity market. This bubble grew while regulators watched and sometimes encouraged. Now that the bubble is deflating and at risk of rupture, it is equally unclear if the CBN, under Sanusi, is ready politically and able financially to intervene should a crisis start. While there may be cause for some optimism for a relatively quick rebound of the global economy, we are concerned that several of our contacts, who also sit on government economic management committees, are failing to account for the risks inherent to the system and the recovery. Sitting back and counting on a rebound in the equity market to re-inflate bank balance sheets is a band aid. The swift removal of these toxic assets from the bank books and the institution of stronger regulation to prevent a return of such troublesome lending are the only long-term solutions.

¶10. (C) Comment continued: New CBN Governor Sanusi has his work cut out for him. While he has a reputation for favoring careful risk assessment and stronger supervision, it remains to be seen whether players in the commercial banking sector and at senior levels of the GON will thwart his presumed intentions to strengthen the sector. It also remains to be seen how much damage his predecessor may have done to the sector and the CBN in his unsuccessful campaign to remain in charge. As noted above, some Southerners are clearly upset with the appointment. One independent businessman went so far as to allege to Abuja Econ Counselor on June 7 that senior leadership within the Presidential Villa had installed Sanusi as MD at First Bank as a prelude to his CBN appointment. This was done with an eye to having the new Governor funnel funds from the CBN and possibly the banking sector more broadly to support the PDP's candidates in the 2011 elections. Possibly the biggest question is whether Sanusi has both

the intentions and the wherewithal to keep others from interfering with the important work facing the CBN as outlined above. End comment.

¶11. (U) This cable has been cleared by Embassy Abuja.

Sanders